Here We Thought It Was A Business Tool

by Steve Brown

Computers have long been an important business tool. Most business people use digital access for pleasure as well - for email, social media etc. Still it was a surprise that a Pew survey of tens of thousands of residents in 32 developing nations found that staying in touch with family and friends was the primary reason people said they used a computer. In fact, 86% of respondents said they go online mostly to contact family and friends. Online shopping and account access were distant also-rans in the measure of computer usefulness.

Consider therefore that financial institutions need a completely different marketing focus to communicate with customers who view the internet primarily as a social tool. Many community bankers in the US have experimented with Facebook pages and LinkedIn, but most have not found them terribly effective in growing new business. Perhaps because computers have had a business role in the US for so long, they are primarily seen as a financial tool for account access and shopping. While banking web sites often resemble a shopping site (CD rate special today!!), do customers really shop for financial services online?

There is a whole subset of lending outside the sphere of regulated financial institutions that is banking its entire business model on the idea that consumers prefer to shop for financial services online. Alternative lending companies like LendingClub distribute capital from investors to borrowers over an internet-based marketplace. They are designed to create a more user-friendly borrower experience than getting a loan in a bank. There is less paperwork, it's fast and it is easier to qualify. Loan qualification is calculated using logarithms which assess risk and assign appropriate pricing.

LendingClub is a serious player in business lending, doing some $6B in loans in sizes up to $300k for as long as 5Ys (as well as for consumer loans). In the banking world, business lending previously depended upon knowledge of the local economy and the business itself. Having this knowledge has always been the primary advantage of the community banker. We trolled the website for LendingClub to learn about their business lending process and we found that business borrowers can apply online in under 5 minutes and funds can be in a customer bank account within days at a fixed rate as low as 5.9%. That is competition, but compared to the sub 4% levels bankers see in many markets, further compression is likely.

Given that market-based lending has typically been aimed at individuals and businesses that don't qualify easily for bank loans, this interest rate is a little surprising. It would typically indicate a desirable bank customer, unless the high level of demand for market-based loans is creating the same kind of margin and pricing compression that is affecting the traditional banking industry. We believe it is.

Hedge funds are the primary investors in market-based lending and large banks are also behind the scenes. As such, these big investors are creating enormous demand. Market-based loans are higher yielding assets than traditional investment vehicles, but we wonder if the algorithms that pricing is based upon are correctly assessing risk, or if they are mostly reflecting competition and the level of demand by investors.

Given a change in economic conditions, these types of loans could well become the next asset class to blow up. Investors will realize that yields were not sufficient to compensate for the level of risk and that advanced algorithms can't substitute for local knowledge. There are lessons for financial institutions here though. Consumers want the loan process to be easier, they are generally going to research and shop online and will not be satisfied with a complicated approval process. Banks should adopt the best practices of the market-placed lenders and focus on a streamlined process combined with good old fashioned customer service to win the day.

BANK NEWS

Huge Restructure

GE said it will sell or spin off $500B GE Capital (7th largest US bank) and exit the banking business over the next 2Ys, as it restructures to avoid high regulatory costs and burdens and investor worries (about stock price volatility due to the business). GE said it plans to keep operations that include aircraft leasing, financing for energy companies, financing for health care and other lines that support is core industrial operations. It also announced it has agreed to sell $26.5B in real estate to Blackstone and Wells Fargo. Finally, it also plans to do a $50B stock buyback and will take a $16B charge related to the divestiture.

M&A Activity

1) Adams Community Bank ($395mm, MA) will acquire The Lenox National Bank ($66mm, MA) for $14.3mm in cash or about 1.71x tangible book. 2) The Andover Bank ($347mm, OH) will acquire Community National Bank of Northwestern Pennsylvania ($77mm, PA) for $19mm in cash.

Rate Hikes

The latest Wall Street Journal survey of blue chip economists finds 18% expect the Fed to raise rates in June and 65% say it will be Sep of this year.

Branch Activity

1) AnchorBank, fsb ($2.1B, WI) will sell 1 WI branch to Premier Community Bank ($266mm, WI) for an undisclosed sum. The branch is reported to have approximately $13mm in deposits.

Investment Banking

Work done by professors at the NYU Stern School of Business finds the average investment banking unit produced a 6.6% ROE in 2014 and only Wells Fargo and Goldman had returns above their estimated 12% cost of capital.

Consolidation

AnchorBank, fsb ($2.1B, WI) said it has offered voluntary buyouts to 19.4% of its employees and will close 6 branches as it moves to improve efficiency.